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16-P-985

Appeals Court

TOWN OF HINGHAM vs. AQUARION WATER COMPANY OF MASSACHUSETTS, INC., & another.<sup>1</sup>

No. 16-P-985.

Suffolk. September 7, 2017. - November 2, 2017.

Present: Vuono, Blake, & Singh, JJ.

Practice, Civil, Declaratory proceeding. Declaratory Relief. Public Utilities, Value. Water Company. Municipal Corporations, Water supply. Statute, Construction. Value. Words, "Actual cost."

Civil action commenced in the Supreme Judicial Court for the county of Suffolk on July 3, 2013.

After transfer to the Superior Court Department, the case was heard by Christine M. Roach, J.

Kerry T. Ryan (Thomas J. Carey, Jr., also present) for the plaintiff.

Joe A. Conner, of Tennessee (Fred A. Kelly, Jr., also present) for the defendants.

BLAKE, J. The plaintiff town of Hingham (town) filed an action for declaratory relief in Superior Court in relation to

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<sup>1</sup> Aquarion Water Capital of Massachusetts, Inc.

its statutory right to purchase the defendant water companies, Aquarion Water Company of Massachusetts, Inc. (Aquarion Mass), and Aquarion Water Capital of Massachusetts, Inc. (Aquarion Capital) (collectively, Aquarion).<sup>2</sup>

The 1879 statute that chartered the original Hingham Water Company, Aquarion Mass's predecessor, provides in part: "The town . . . shall have the right . . . to purchase the corporate property [of the company] . . . at the actual cost of the same, together with interest thereon at a rate not exceeding ten per centum per annum, . . . deducting from said cost any and all dividends which may have been paid." St. 1879, c. 139, § 11 (hereinafter, charter or statute). The town seeks a declaration (1) as to the purchase price if it were to exercise its right, and (2) whether a water treatment plant (WTP) owned by Aquarion Capital would be included in the corporate property under the statute.

Following a five-day jury-waived trial, the judge ruled in a written decision that the WTP was to be included in any future purchase, provided the parties a formula for calculating the purchase price, and instructed them to cooperate to submit a proposed final judgment. When the parties could not reach

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<sup>2</sup> Aquarion Mass and Aquarion Capital are subsidiaries of the Aquarion Water Company, which also has acquired water companies in, among other locations, New Hampshire and Connecticut. Aquarion Water Company is but one level of a chain of corporate entities owned by Macquarie Utilities, Inc.

agreement, however, the judge, having reviewed additional posttrial submissions, ordered in her second decision that final judgment enter on a price of \$88,585,821 as of December 31, 2013. Both parties now appeal, challenging the judge's interpretation of the term "actual cost." Aquarion also challenges the judge's ruling as to the sale of the WTP. We affirm.

Background. The facts of the case are undisputed. The statute chartering the Hingham Water Company was enacted in 1879; Aquarion Mass currently owns all of the stock of the company. In 1994, construction of the WTP began.<sup>3</sup> In 1995, a separate company was formed for the sole purpose of acquiring, developing, financing, and leasing the WTP; after several corporate transactions, that company is now Aquarion Capital. Because the WTP was financed primarily through debt (in the form of bonds), a separate corporate structure was required to avoid violations of Aquarion Mass's<sup>4</sup> mortgage indenture obligations. After completion of the WTP, Aquarion Mass and Aquarion Capital entered into a lease agreement that gives the town the express

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<sup>3</sup> At that time, the Department of Environmental Protection required that a plant be built to treat the surface water supplying the Hingham system.

<sup>4</sup> When the WTP was built, the Hingham Water Company had a different corporate identity, and was not yet Aquarion Mass. At the time, the same was true for Aquarion Capital. For ease of reference, we refer to the corporations as Aquarion Mass and Aquarion Capital, or collectively as Aquarion.

right to assume the lease if the town acquires the water system. The WTP is an integral part of the Hingham water system, treating practically all of the water that is distributed through the system.

At trial, Carl Jenkins, an expert for the town, offered three alternative opinions as to the meaning of "actual cost" -- with three corresponding price calculations. Two of the opinions based the formula on the calculated investor equity in Aquarion over different periods of time, and then added ten percent interest. The third calculated the net plant, which is the gross plant (the accumulated cost of all of the tangible corporate property) minus depreciation. In his third opinion, however, Jenkins calculated the ten percent interest on only the contributed equity figure from his second opinion, rather than on the actual cost of the corporate property as purchased through both equity and debt.

Three experts testified for Aquarion. John Guastella offered a rebuttal of Jenkins's testimony, but no calculations of his own; Michael Lee Altland provided an analysis of fair market value of only the WTP;<sup>5</sup> and Robert Reilly performed

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<sup>5</sup> Counsel for Aquarion contended at trial that the fair market value of the WTP was relevant to the extent that the charter does not include the WTP and the town took it by eminent domain. Neither the town nor Aquarion takes the position on appeal that fair market value is relevant to the valuation of Aquarion under the charter.

independent calculations for a purchase price formula based on components defined and provided to him by counsel. Relevant here, Guastella critiqued Jenkins's use of equity only in the interest calculation<sup>6</sup> and opined that depreciation should not be deducted in the actual cost analysis, as it results in a so-called "book value."

In her decision, the judge found that, because the WTP is an integral part of the water system in Hingham, it necessarily must be included in the sale, regardless of the fact that it has a separate corporate identity. As for depreciation, she concluded that, because the predecessors of Aquarion "have already received any depreciation recovery due on their respective investments[,] . . . depreciation is appropriately deducted in the formulaic calculation of actual cost to be paid by the [t]own." As for the debt issue, the parties could not reach agreement on the meaning of the judge's decision. In essence, the parties' differing interpretations boiled down to (1) whether the statutory ten percent interest should be applied only to the amount of equity invested, as the town argues, or, as Aquarion argues, to the amount originally paid for corporate property (whether by equity or debt financing), and (2) whether

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<sup>6</sup> Guastella testified: "[Actual cost] never means equity. It never means contributed capital. Actual cost invariably means the actual, original cost of the utility assets when first devoted to public use."

the interest paid to the bondholders that financed the purchase of corporate property should be subtracted, essentially because it is not an actual cost.

The judge clarified the issue in her second written decision. The two decisions, read in harmony with each other, make clear that the judge found on the first point that statutory interest should be applied to the original cost of corporate property whether purchased by debt or equity and, on the second point, that bondholder interest payments should be subtracted. Thus, the judge reached the following formula: (a) total gross plant, minus depreciation, minus contributions in aid of construction, and minus advances, equals "net plant"; (b) plus ten percent simple interest on net plant from 1879 to purchase date; (c) minus actual interest paid to bondholders; (d) minus all dividends paid from 1879 to purchase date. Applying this formula to figures agreed to by the parties, the judge concluded that the total purchase price as of December 31, 2013, was \$88,585,821. In their cross appeals, the parties raise the same issues before this court.

Discussion. In reviewing the parties' claims, we accept the judge's findings of fact unless clearly erroneous, but review her conclusions of law de novo. See Martin v. Simmons Properties, LLC, 467 Mass. 1, 8 (2014).

1. Inclusion of the WTP in the purchase. Aquarion argues that because Aquarion Capital is not a successor in interest to the Hingham Water Company, the statute does not apply to it. Therefore, Aquarion argues, if the town purchases Aquarion Mass, it can simply assume the lease that Aquarion Mass has with Aquarion Capital, or pursue an acquisition of Aquarion Capital through eminent domain proceedings. We agree with the judge that because the WTP is an integral part of the town's water system, it must be included within the corporate property. Aquarion's reliance on the statutory language -- which refers to a single "company" -- is misplaced.

The Supreme Judicial Court made clear in a similar statutory water charter case that such statutes are to be interpreted in a manner that effectuates the statute's purpose, i.e., to fairly reimburse a company for its investment, rather than holding to a precise historical interpretation of the statutory language. See Oxford v. Oxford Water Co., 391 Mass. 581, 588 (1984) ("What was reasonable in 1904 may be far from reasonable in 1984, and it may be necessary to use some method other than that provided by the statute to effectuate the statute's purpose"). Employing this reasonableness approach, the fact that the town's water system is technically comprised of two water companies is no bar to allowing the purchase of a complete system. See Dedham Water Co. v. Dedham, 395 Mass. 510,

521 (1985) (statute governing water purchase option could not be interpreted to "dismember an existing water company").

Moreover, to hold otherwise, as the judge observed, "would also more generally allow private companies to agree to corporate structures, for whatever business purpose, which could then result in 'depriving' towns of their statutory exercise."

2. Actual cost formula. In their respective appeals, the parties do not challenge the findings of fact, raw figures, or the judge's arithmetic in applying the net plant approach. Nor do they dispute the judge's ruling that "'actual cost' means the original cost of the corporate property." Rather, they disagree about the formula to be used to arrive at that figure, and the judge's treatment of depreciation and debt. We address each point in turn.

a. Total contributed equity. The town advocates for the application of Jenkins's total contributed equity approach instead of the net plant approach. According to the town, "[t]his method of calculation effectuates the statutory purpose of reimbursing investors for the actual cost of their investment in the enterprise together with a reasonable return thereon." See generally Oxford, 391 Mass. at 589-592. See also Opinion of the Justices, 300 Mass. 607, 613-614 (1938) (alternate calculation to that set forth in charter might be constitutional if it provides for payment of "full and complete compensation"



for property of water company, is not confiscatory, and assures "fair valuation"). Here, we agree with the judge that total contributed equity is not an appropriate means by which to calculate the price the town must pay because there has been no showing that it assures a fair valuation consistent with the Legislature's intent. The total contributed equity approach does not represent, or even attempt to approximate, the actual cost or the amount of money originally spent on corporate property. Nor has it been demonstrated that interest only on the investors' contributed equity was all that was intended by the Legislature in the charter. Compare Oxford, supra. We conclude that the judge did not err in rejecting the total contributed equity approach or in adopting the net plant approach, which is based on the original cost of the corporate property.

b. Depreciation. In Southbridge v. Southbridge Water Supply Co., 371 Mass. 209, 215 (1976) (Southbridge I), the Supreme Judicial Court addressed an analogous inquiry about the meaning of the term "actual cost" in a similar statutory charter granted to a water company in 1880. In that case, the court held that "such term 'is not a technical one having at all times the same meaning. It is a general or descriptive term which may have varying meanings according to the circumstances in which it is used.'" Ibid., quoting from Boston Molasses Co. v. Molasses

Distrib. Corp., 274 Mass. 589, 594 (1931). This flexible view afforded to the cost formula of water charter statutes is consistent with the court's emphasis in Oxford on the method that best achieves the purpose of the charter.

True to its professed nonstatic approach in these types of cases, the Supreme Judicial Court took different tacks on depreciation in Oxford and Southbridge I. In the latter, where the water company had recovered the depreciation "accrued on capital items over the years . . . through the rates which it has been permitted to charge its customers," the court adopted "the town's suggestion that [the court] in effect define 'actual cost' in substantially the same terms as are employed regularly by the Department of Public Utilities and approved by this court in determining the rate base of the company and of other regulated utilities in the Commonwealth for rate setting purposes." Southbridge I, supra at 216. There, the rate base was computed "on the basis of original cost of plant, less accrued depreciation and less certain other deductions."<sup>7</sup> Ibid.

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<sup>7</sup> Other deductions generally taken in computing the "rate base" included "plant under construction, property held for future use, and cash working capital." New England Tel. & Tel. Co. v. Department of Pub. Util., 331 Mass. 604, 607 (1954). In Southbridge I, the Supreme Judicial Court noted that a deduction for "plant under construction" would be inappropriate in a calculation designed to determine "actual cost." 371 Mass. at 216-217. The court declined to express "any view whether other exceptions to the rate base formula should be made in determining 'actual cost.'" Id. at 217. Both Southbridge I and

In Oxford, 391 Mass. at 590 n.8, on the other hand, the court did not include a deduction for depreciation. In that case, however, the record did not demonstrate that depreciation had been taken into account in the rate setting process. Ibid. Later, when presented with this apparent inconsistency, the Supreme Judicial Court did not overrule Southbridge I, thereby underscoring its individualized approach in these types of cases. See Southbridge v. Southbridge Water Supply Co., 411 Mass. 675, 676-677 (1992).

Here, the judge found that depreciation is an accounting principle whereby Aquarion recovers the price it paid for an asset over the life of that asset. The judge also found, and neither party disputes, that, going back to 1884, and beginning yearly in 1909, Aquarion and its predecessors reported depreciation as a noncash expense. It is of note that, had depreciation not been treated in this manner, Aquarion may have paid larger dividends.<sup>8</sup> We agree with the judge's conclusion that depreciation is to be deducted in the actual cost analysis. This case is more akin to Southbridge I, and Aquarion is not

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Oxford recognize that certain deductions from the original cost of the plant are appropriate in determining actual cost. Aquarion's suggestion that "any" deduction other than dividends (even deductions that reflect its previous recovery of certain costs) deviates from the statute is specious.

<sup>8</sup> The charter provides for deduction of "any and all dividends which may have been paid" by the Hingham Water Company (emphasis supplied).

entitled to what essentially would be a "double recovery" on an expense already repaid. 371 Mass. at 216.

c. Debt. Both parties appeal on the issue of debt, and how it intersects with the calculation of interest. For its part, the town argues that the ten percent statutory interest should be calculated only on the equity invested in the WTP, not on the combined equity and debt used to finance its purchase, which the town argues would result in a windfall to Aquarion. For example, although the WTP's cost was approximately \$40 million, Aquarion Capital contributed only about \$5 million in equity and financed the remaining \$35 million. The town contends that interest should not be calculated on the amount financed because for only a \$5 million equity contribution, Aquarion Capital will have earned \$4 million of interest each year since the WTP was constructed. According to the town, "the Legislature never intended to authorize a [ten percent] return on borrowed money supplied by others with interest and principal being paid out of customers' rates."

We have some sympathy for the position the town finds itself in, but we agree with the judge's conclusion that the interest rate of ten percent applies to actual cost, including the amount paid to contractors and vendors for corporate property, whether paid with equity or through debt. Neither the statute itself, nor any of the pertinent case law,

differentiates corporate property purchased through equity or debt financing.<sup>9</sup> Viewing the issue from a commonsense perspective as well, the term "actual cost" seeks to quantify what Aquarion and its predecessors paid to contractors and vendors for the corporate property at issue. Whether those payments were by acquiring debt or through equity is immaterial to that calculation. While the town characterizes the interest calculation as "interest on debt," it in fact is nothing other than interest on the actual cost of the corporate property.

Finally, Aquarion claims that the interest paid to bondholders on the debt should not have been deducted, as such a deviation moves too far from the language of the statute and the approaches endorsed in the case law. Indeed, Aquarion suggests that interest is "simply a business cost -- a cost of capital" and excluding interest on bonds would be akin to subtracting "the amount of electricity expense . . . or the payroll expense, or any other cost of service." Where actual cost has been defined as the original cost paid for corporate property, however, Aquarion has failed to demonstrate that interest paid

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<sup>9</sup> The town bolsters its argument with citations to Oxford to suggest that property so financed should be excluded because it is property added to the system paid for by others. 391 Mass. at 590-591. The town is attempting to equate contributed property, which is the subject in Oxford, with general corporate property purchased through debt. Here, as in Oxford, contributed property is a category deducted from actual cost, a point neither party disputes.

on the debt incurred constitutes a component of actual cost as that term is used in the charter. We agree with Aquarion that the financing of the actual cost is a business expense and essentially constitutes a business decision. The record suggests that interest charges have been recaptured through rate setting.<sup>10</sup> The formula set forth in the charter, which was agreed to by the Legislature and the incorporators, does not include a calculation of interest on the costs of doing business. Aquarion has failed to persuade us that interest on corporate debt should be treated differently from other business costs. Certainly, interest paid to bondholders is not a component of the actual cost paid to contractors and vendors for corporate property.

Contrary to Aquarion's argument, making certain deductions to arrive at actual cost does no injustice to the statute. See Southbridge I, supra at 216 (noting reliance on "rate base" calculation which includes original cost of plant, less accrued depreciation and "certain other deductions"). The judge did not alter the formula set forth in the charter but, rather, stayed true to the formula despite it resulting in a potentially untenable price. Compare Opinion of the Justices, 300 Mass. at 611-614 (proposed amendment to statute chartering Hingham Water

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<sup>10</sup> The judge found that when the principal debt was refinanced at a lower cost, the savings were passed on to ratepayers.

Company, which would reduce interest from ten percent to five percent and allow town to assume company's debt and to capture certain reserved funds, would change calculation of actual cost in manner less favorable to company). Here, the judge resolved the question of which expenses are properly included in a computation of actual cost. She did not allow the town to assume Aquarion's debt and she did not reduce the interest rate.

Where the term "actual cost" is not defined in the charter, the term must be interpreted according to the intent of the Legislature. Oxford, 391 Mass. at 587. Indeed, in Oxford, supra, the Supreme Judicial Court observed again that "[u]nderstanding the intent of the Legislature is far more important than ascertaining how the term 'actual cost' was defined in [an 1879] dictionary." Interpreting the statute's language on a case-by-case basis, as endorsed by both Oxford and Southbridge I, is not a "de facto statutory amendment" or a violation of constitutional rights, as claimed by Aquarion.<sup>11</sup> For the foregoing reasons, we affirm.

Judgment affirmed.

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<sup>11</sup> We decline the invitation of the town to appoint a master.